11-1800-9626-2

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA DEPARTMENT OF HUMAN SERVICES

In the Matter of the Contested Case of Stevens Square Nursing Home,
Appellant,

vs.

Minnesota Department of Human Services,
Respondent.

RECOMMENDED ORDER ON MOTIONS FOR PARTIAL SUMMARY DISPOSITION

The above-captioned matter is pending before Administrative Law Judge Barbara L. Neilson pursuant to a Notice of and Order for Hearing and Prehearing Conference issued by the Deputy Commissioner of the Minnesota Department of Human Services on April 14, 1995. Both parties have moved for summary disposition on two issues in this matter. The record regarding these motions closed on January 30, 1996, when the Department's reply was received.

Theresa M. Couri, Assistant Attorney General, 445 Minnesota Street, Suite 900, St. Paul, Minnesota 55101-2127, appeared on behalf of the Department of Human Services ("DHS" or "the Department"). Thomas L. Skorczeski, Orbovich & Gartner, Chartered, 445 Minnesota Street, Suite 710, St. Paul, Minnesota 55101, appeared on behalf of Appellant, Stevens Square Nursing Home ("Stevens Square" or "the Facility").

Based upon all of the files, records, and proceedings herein, and for the reasons set forth in the accompanying Memorandum,

IT IS HEREBY RESPECTFULLY RECOMMENDED that the Department's Motion for Partial Summary Disposition be GRANTED and the Facility's Motion for Partial Summary Disposition be DENIED.

IT IS FURTHER ORDERED that a telephone conference call to discuss the status of the remaining issues in the case and motion and/or hearing schedules shall be held on Thursday, March 14, 1996, at 2:30 p.m. The Administrative Law Judge will initiate the call.

Dated this _____ day of February, 1996.

_____
BARBARA L. NEILSON
Administrative Law Judge

MEMORANDUM

Stevens Square Nursing Home operates a nursing home in Minnesota and receives reimbursement from the Department for allowable costs incurred in providing care to residents under the federal Medicaid Act, 42 U.S.C. § 1396a, and the State's Medical Assistance Program, Minn. Stat. Ch. 256B. The reimbursement rates at issue in this proceeding were set under Minn. Stat. § 256B.431 and Minn. Rules 9549.0010-.0080 ("Rule 50"). To receive medical assistance payments, nursing homes submit annual cost reports showing costs incurred during the reporting year, which generally runs from October 1 through the following September 30. Minn. R. 9549.0041, subp. 1. During desk audits, DHS auditors review the cost reports and supporting documentation. Minn. R. 9549.0020, subp. 19 and 9549.0041. The auditors allow, disallow, or reclassify costs reported on the provider's cost report and, based upon adjusted allowable costs, calculate a prospective per diem rate for a rate year running from July 1 through the following June 30. Minn. R. 9549.0041, subp. 11, 13. Providers may appeal specific audit adjustments after they receive the final rate notice. Minn. Stat. § 256B.50, subd. 1b. If the appeal is not resolved informally, the provider may demand a contested case hearing. Minn. Stat. § 256B.50, subd. 1h.[1]

In 1990, Stevens Square entered into a revenue bond financing agreement to fund a major construction project. The Facility sought to have its interest expenses arising from that project's financing included in the reimbursement rate. The Facility also sought to obtain an equity incentive payment rate under Minn. Stat. § 256B.431, subd. 16, for its equity interest in the project. Stevens Square incurred the following costs in connection with its 1990 construction project:

Land Improvements	$ 9,700	
Buildings	2,556,353	
Fixed Equipment	207,320	
Subtotal	2,773,283	
Moveable Equipment	117,245	
Reserve Deposit	268,000	
Issuance Costs	155,799	
Subtotal		
TOTAL		541,044
	3,314,327	

Department's Memorandum at 4; Facility's Memorandum, Exs. 2-3.

To finance the costs of the project, Stevens Square participated in a bond issue in the amount of $3,000,000 and contributed $314,347 out of its own funds. Department's Memorandum at 4; Facility's Memorandum at 10. The Department conducted desk audits of the cost reports submitted by Stevens Square for the July 1, 1993, July 1, 1994, and July 1, 1995, rate years. Stevens Square appealed the Department's calculation of allowable interest expense and its determination that the

Facility did not qualify for an equity incentive payment rate, and requested a hearing pursuant to Minn. Stat. § 256B.50, subd. 1h. This contested case proceeding followed.

Both the Department and Stevens Square have filed motions for partial summary disposition in this matter on the allowable interest and equity incentive issues. Summary disposition is the administrative equivalent to summary judgment. Minn. Rules pt. 1400.5500(K). Summary judgment is appropriate where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Sauter v. Sauter, 70 N.W.2d 351, 353 (Minn. 1955); Louwagie v. Witco Chemical Corp., 378 N.W.2d 63, 66 (Minn. App. 1985); Minn. R. Civ. P. 56.03. The Office of Administrative Hearings has generally followed the summary judgment standards developed in judicial courts in considering motions for summary disposition. See Minn. Rules pt. 1400.6600.

It is well established that, in order to successfully resist a motion for summary judgment, the nonmoving party must show that specific facts are in dispute which have a bearing on the outcome of the case. Hunt v. IBM Mid America Employees Federal Credit Union, 384 N.W.2d 853, 855 (Minn. 1986). The existence of a genuine issue of material fact must be established by the nonmoving party by substantial evidence; general averments are not enough to meet the nonmoving party's burden under Minn. R. Civ. P. 56.05. Id.; Murphy v. Country House, Inc., 307 Minn. 344, 351-52, 240 N.W. 2d 507, 512 (1976); Carlisle v. City of Minneapolis, 437 N.W.2d 712, 715 (Minn. App. 1988). Summary judgment may be entered against the party who has the burden of proof at the hearing if that party fails to make a sufficient showing of the existence of an essential element of its case after adequate time to complete discovery. Id. To meet this burden, the party must offer "significant probative evidence" tending to support its claims. A mere showing that there is some "metaphysical doubt" as to material facts does not meet this burden. Id.

Based upon the memoranda and affidavits filed by the parties, there appear to be no relevant facts in dispute regarding the allowable interest and equity incentive issues. The disagreement between the parties turns on the legal issues of what calculation is appropriate to establish the amount of debt incurred that is allowable and what calculation is proper to determine the correct equity incentive payment. These issues are discussed below.

Calculation of Allowable Debt and Interest

Pursuant to Rule 50, providers are reimbursed for certain costs. The Department allows or disallows debt when it establishes the property related payment rate. Minn. R. 9549.0060, subp. 5. Subpart 5 (A) provides that "[d]ebt incurred for the purchase of land directly used for resident care and the purchase or construction of nursing facility buildings, attached fixtures, or land improvements or the capitalized replacement or capitalized repair of existing buildings, attached fixtures, or land improvements shall be allowed. Debt incurred for any other purpose shall not be allowed." Rule 50 further provides that "[i]nterest expense is allowed only on the debt which is allowed under subpart 5 and within the interest rate limits in subpart 6." Minn. R. 9549.0600, subp. 7(A). Thus, DHS auditors reviewing costs reported by facilities during desk audits only allow interest expense claimed by facilities if it is tied to the categories of allowable debt that are

set forth in subp. 5(A)(1), quoted above. See Affidavit of Terri Engel, ¶¶ 8, 10 (appended to the Department's Memorandum).

In the present case, Stevens Square merely provided documentation of the project costs subject to financing, which totaled $3,314,327. The Facility did not provide the Department with documentation to show that the $3,000,000 of loan proceeds were applied to the purchase of items giving rise to allowable debt (i.e., land, buildings, land improvements, and attached fixtures). Because the debt proceeds were not tied to specific categories of allowable debt, the Department did not have a sufficient basis to allow 100% of the debt. Engel Affidavit, ¶ 9. The Facility also did not submit documentation showing the categories of costs for which the $314,327 in funds provided by Stevens Square were used. Pursuant to Rule 50, the Facility is not entitled to reimbursement for interest expense for use of its own funds for this type of project. Minn. R. 9549.0060, subp. 5(A)(1) and 7(A). Therefore, even if the $314,327 was applied to an allowable category, the Facility would not be entitled to reimbursement for interest on those costs because Rule 50 only permits reimbursement related to actual debt incurred.

When debt proceeds are identified to a project which includes expenditures that give rise to allowable debt (land, buildings, fixtures, and land improvements) as well as expenditures that do not give rise to allowable debt (financing costs, debt reserve funds, and movable equipment), it has been the long-standing practice of the Department to determine the amount of allowable debt through the use of a ratio. This ratio is computed by dividing the project costs which relate to the purchase of land, buildings, land improvements, and attached fixtures by the total project costs. Engel Affidavit, ¶¶ 9-11. In this case, the Department divided $2,773,283 (the cost of the land, buildings, and attached fixtures) by $3,314,327 (the total project cost) to arrive at 83.68% as the percentage of debt allowable. The Department then applied this percentage figure to determine allowable debt and recognized an identical percentage of total bond interest as an allowable expense. The Facility contends that the denominator used in the ratio calculating the percentage rate should have been $3,000,000 (the total debt) rather than $3,314,327 (the total project cost). The Facility's proposed calculation would result in a higher percentage figure of 92.44%. See appeal letters appended to the Notice of and Order for Hearing. The Facility contends that the Department erred in using a value for the denominator that was larger than the total value of the bond issue. In essence, Stevens Square argues that the cash it contributed to the project should be treated as allocated to nonallowable costs. There is, however, nothing in the record to show that the cash was applied in that fashion.

The Department used the total cost of the project as the denominator in the calculation rather than just the amount of the total debt because it had no basis for separating the debt ($3,000,000) from the non-debt ($314,327) in applying these amounts to the specific costs of the project. Engel Affidavit, ¶ 11. The plain language of Minn. R. 9549.0060, subp. 5(A), indicates that providers are to be reimbursed for interest expense only if it is related to certain categories of debt. The method consistently used by the Department to compute allowable debt and interest in the absence of provider documentation of the allocation of debt and cash outlays conforms to the language and intent of the rule. The Department divided allowable costs ($2,773,282) by the total cost of

the project ($3,314,327) and multiplied the result by the total debt incurred ($3,000,000) to determine the amount of the debt which is allocated to allowable costs. See Facility's Memorandum, Ex. 2. The approach taken by the Department permits it to recognize the percentage of the total debt that is proportional to the ratio of allowable costs and total (allowable and nonallowable) costs. The Department's approach is logical and in conformity with the rule's intent to render some types of debt allowable, but not all debt.

The Administrative Law Judge thus concludes that the Department correctly calculated the amount of allowable debt and interest. The Department's approach is consistent with the plain language and intent of Rule 50. See Mapleton Community Home v. Department of Human Services, 391 N.W.2d 798, 802 (Minn. 1986) (Department's utilization of a ratio not specified in statute or rule was upheld where the ratio "translated Rule 50 from words to numbers"). Accordingly, the Department is entitled to judgment on this issue as a matter of law.

Calculation of Equity Incentive Payment Rate

Minn. Stat. § 256B.431, subd. 16 sets out the method to be used to calculate the equity incentive payment rate afforded to providers who make major additions or replacements:

> An eligible nursing facility shall receive an equity incentive payment rate equal to the allowable historical cost of the capital asset acquired, minus the allowable debt directly identified to that capital asset, multiplied by the equity incentive factor as described in paragraphs (b) and (c), and divided by the nursing facility's occupancy factor under subdivision 3f, paragraph (c). This amount shall be added to the nursing facility's total payment rate and shall be effective the same day as the incremental increase in paragraph (d) or subdivision 17. The allowable historical cost of the capital assets and the allowable debt shall be determined as provided in Minnesota Rules 9549.0010 to 9549.0080, and this section.

Minn. Stat. § 256B.431, subd. 16(a) (1994). Thus, the equity incentive payment rate is calculated by subtracting the allowable debt identified with a project from the allowable historical cost of the project. This difference is then multiplied by a calculated equity incentive factor and that result is divided by the provider's capacity days to yield a per diem rate.

Stevens Square applied for the equity incentive rate payment with respect to the construction project discussed above. The Department determined that Stevens Square was not eligible for an equity incentive payment because "the cost of the project exceeded the maximum replacement cost new limitation; therefore it is not allowable for purposes of calculating the equity incentive." DHS Determination of Long Term Care Rate Appeal, March 31, 1995, at 2 (attached to Facility's Memorandum as Ex. 2).

The Facility asserts that the concept of "maximum replacement cost new limitation" is not included in the procedures defined by the Legislature to determine eligibility for an

equity incentive payment and that the Department's use of the concept violates the express language of the statute. The Facility argues that the Department has improperly imposed a limitation that was created for an entirely separate rate setting purpose. Stevens Square also contends that the statute mandates that the equity incentive computation be separate from the determination of the facility's rental rate, thereby underscoring the fact that other concepts cannot be imported to the calculation.[2] The Facility urges that the Administrative Law Judge require the Department to reconsider its eligibility for an equity incentive payment rate without applying the "maximum replacement cost new limitation."

The Department responded that its interpretation of allowable historical cost is consistent with the statutory language and with other provisions of the property rate setting system. It argues that its application of the "maximum replacement cost new limitation" is necessary to give meaning to the Legislature's mandate in Minn. Stat. § 256B.431, subd. 16 (1994) that "allowable historical costs" be calculated. The Department contends that the Facility's assertion that the limitation should not be applied here amounts to an attempt to change the statutory language to require mere calculation of "historical costs." The Department asserts that its interpretation of the statute "gives the word 'allowable' the most reasonable meaning in the context--the amount of project cost that is allowable for rate-setting purposes." Department's Memorandum at 13. In addition, the Department points out that it would be inconsistent with the concept of limits on replacement cost new if facilities were provided an incentive to exceed those limits. The Department argues that the language contained in Minn. Stat. § 256B.431, subd. 16 (1994), merely means that the equity incentive payment rate should not fluctuate from year to year in response to changes in other payment rates.

The arguments of the parties are virtually identical to those raised in another recent contested case proceeding addressing the calculation of the equity incentive rate. In that case, Judge Reha recommended to the Commissioner that the Department be granted summary disposition. Judge Reha approved the approach used by the Department in calculating the equity incentive rate, noting as follows:

> The effect of using the Providers' approach would be to allow payments without limits on the cost of the capital additions. With the word "allowable" in that statute, the plain language suggests that limitations exist on what costs should be considered in the calculation of the equity incentive rate. Subdivision 16(a) expressly states "The allowable historical cost of the capital asset and the allowable debt shall be determined as provided in Minnesota Rules, parts 9549.0010 to 9549.0080, and this section." This is an express indication that the statutory intent is for the Rule 50 limitations on allowability to be applied in calculating the equity incentive rate.
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> Providers argue that there is a distinction between "allowable costs" and "allowed costs" and the statute requires allowable costs be used to calculate the equity incentive rate. Appellants' Memorandum in Response, at 9. Subdivision 16(a) does not have any language that supports this interpretation. Subdivision 16(b)(1) refers to the "initial historical cost of the

capital asset additions referred to in paragraph (a)" as the starting point of the calculation. The language in paragraph (a) of Subdivision 16 has an outline of the same calculation and specifies that the "allowable historical cost" is to be used. The Legislative intent is to use the limitations in Rule 50 to establish the proper starting point for the equity incentive rate. DHS followed the proper procedure in calculating that rate.

In the Matter of the Contested Case of Mankato Lutheran Home and Itasca Nursing Home v. Minnesota Department of Human Services, OAH Docket No. 9-1800-9041-2 (Recommended Order on Motion for Summary Disposition, Aug. 10, 1995), at 9. The Commissioner's final order in the Mankato Lutheran Home case has not yet been issued.

The Administrative Law Judge finds the reasoning of Judge Reha in Mankato Lutheran Home to be persuasive in this case and reaches the same result in the case at bar. The Department correctly incorporated the concept of maximum replacement cost new in assessing whether Stevens Square was eligible for the equity incentive payment rate. Its approach is not contrary to the governing statute but, rather, is consistent with the statute's directive to consider the "allowable historical cost" of the capital asset acquired.

There are no genuine issues of material fact that remain for hearing regarding the allowable debt and equity incentive payment issues. Stevens Square has not demonstrated that the Department erred in calculating allowable debt and interest or the equity incentive rate. The Department has shown that it followed proper procedures under governing statutes and rules in doing its desk audit calculations. Therefore, the Administrative Law Judge recommends that the motion of the Department for summary disposition be granted and that the motion of the Facility for summary disposition be denied. Because the Facility has raised other issues in its underlying appeal letters, a conference call has been scheduled to discuss briefing and/or hearing schedules with respect to the remaining issues.

B.L.N.

[1] Based upon the agreement of the parties, the Facility's appeals for the July 1, 1994, and July 1, 1995, rate years were included in this contested case proceeding. The Motions for Partial Summary Disposition filed in the present case involve Stevens Square's demands for hearing on two appeal items remaining in dispute for rate years beginning July 1, 1993, July 1, 1994, and July 1, 1995. Summary disposition is not sought at the present time with respect to the Facility's demands for hearing on appeal items remaining in dispute for rate years beginning July 1, 1983, July 1, 1984, or July 1, 1991.

[2] The Facility contends that the "maximum allowable replacement cost new limitation" is only applicable when calculating a provider's rental payment rate. See Minn. Stat. § 256B.431, subd. 17(e) (1994). The Facility asserts that the legislature confirmed the fact that the limitation did not apply when calculating an equity incentive payment rate by its indication that "computation [of the equity incentive] is separate from the determination of the nursing facility's rental rate." Minn. Stat. § 256B.431, subd. 16 (1994).